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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1978

NO. 78-58

G. GARVIN BROWN, III, Petitioner,

v.

MARK PAUL FELSEN, Respondent.

PETITIONER'S SUPPLEMENTAL MEMORANDUM

DEANNA E. HICKMAN
DAWSON, NAGEL, SHERMAN
& HOWARD
2900 FIRST OF DENVER PLAZA
633 SEVENTEENTH STREET
DENVER, COLORADO 80202

COUNSEL FOR PETITIONER

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The Third Circuit recently addressed the issue of the res judicata effect of a state court judgment in a subsequent bankruptcy proceeding. In In re McMillan, [1978] 2 Bankr. L. Rep. (CCH) ¶ 66,883 (3d Cir., filed June 21, 1978), the Court considered the dischargeability of a debt,

evidenced by a state court judgment, under § 17 of the Bankruptcy Act, as amended (11 U.S.C. § 35). The Third Circuit carefully analyzed both the law and the underlying policy of 11 U.S.C. § 35 and determined that a state court default judgment, even though expressly based on fraud, did not estop the parties from litigating the issues of fraud and dischargeability in a subsequent bankruptcy proceeding.

The Court of Appeals agreed with the bankruptcy judge's determination that he is

> still bound to ascertain for . . . [h]imself that the elements of an exception to dischargeability established by § 17a(2), have been fully proved by the Plaintiff. This cannot be accomplished by mere reference to the wording of an earlier judgment. [1978] 2 Bankr. L. Rep. (CCH) ¶ 66,883 at 76,858.

This squarely contradicts the position of the Tenth Circuit in this case, that a state court judgment is determinative of the issue of dischargeability.

In McMillan, the Court of Appeals focused on the policy underlying the 1970 amendments to 11 U.S.C. § 35 as well as the significant practical problems raised by the issues presented. Several elements form the basis of its decision. First, the state court action was not "actually litigated." Essential to the applicability of the doctrine of res judicata is that the issue have been actually litigated. A default judgment, or stipulated judgment, involves no determination by the finder of fact and provides no real guidance on the merits of the case to courts which may later have cause to consider the judgment.

Second, the facts and issues peculiar to 11 U.S.C. § 35 would not be determined in a state court proceeding. The 1970

amendments to that section changed the law and vested in the bankruptcy court exclusive jurisdiction to determine the dischargeability of debts falling within 11 U.S.C. § 35(a). Res judicata cannot apply to issues which are outside the jurisdiction of the particular forum. Since a state court cannot bindingly determine dischargeability, it is unlikely that a party would plead the elements required by 11 U.S.C. § 35 in a state court proceeding.

Third, policy considerations should prevent the rigid application of res judicata to default and other similar judgments. Such a rule undermines the purpose of 11 U.S.C. § 35, as well as causes needless litigation. As the Third Circuit stated:

> [G]iving full collateral estoppel effect to all facts necessarily determined by a prior default judgment would in

> bankruptcy court determinations under § 17a(2)--
>
> ". . . necessarily defeat a major federal policy of granting exceptions to discharge only in certain circumstances specified by the Bankruptcy Act. . . .
>
> The court also wishes to point out that creditors should not be encouraged to go into state courts prior to bankruptcy seeking default judgments based on fraud. Such a circumstance would create an injustice greater than that which the 1970 amendments were intended to cure." [1978] Bankr. L. Rep. (CCH) ¶ 66,883 at 76,860.

An additional consideration is the practical one of the courts' own dockets.

In order to protect against the situation this petitioner has encountered, the parties will be forced to raise and have tried superfluous issues in order to protect against a future bankruptcy. The Third Circuit, quoting Professor Moore's treatise, recognized the practical administrative problems inherent in such a situation:

> The defendant in a suit should not be compelled, at his peril, to embark on extensive litigation involving perhaps some minor matters in order to prevent the operation of a judgment which would be held conclusively to have established against him every material fact alleged and not denied in the declaration, so as to preclude him from showing the truth if another controversy should arise between the same parties. [1978] 2 Bankr. L. Rep. (CCH) ¶ 66,883 at 76,860.

These same elements are present in the instant case, yet were apparently ignored by the Tenth Circuit in reaching its conclusion.

The decision in In re McMillan sharply contrasts with the Tenth Circuit's unwavering position that a bankruptcy court is bound by a state court judgment on the character of the claim and hence its dischargeability, and highlights the significant practical problems now facing litigants and the courts in this area.

CONCLUSION

For the reasons set forth herein, and in the Petition for a Writ of Certiorari, a writ of certiorari should issue to review the judgment and opinion of the Tenth Circuit.

Respectfully submitted,

Deanna E. Hickman
DAWSON, NAGEL, SHERMAN &
HOWARD
2900 First of Denver Plaza
633 Seventeenth Street
Denver, Colorado 80202

Counsel for Petitioner

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